Welcome to a satisfying experience

THE KEG
ROYALTIES INCOME FUND
ANNUAL REPORT 2003

THE KEG
STEAKHOUSE & BAR

HIGHLIGHTS

($000's except earnings per unit amounts)	Jan. 1 to Dec. 31, 2003	May 31 to Dec. 31, 2002
Restaurants in the Royalty Pool	81	80
Gross sales reported by restaurants in the Royalty Pool	$ 280,317	$ 157,547
Royalty income	$ 11,248	$ 6,356
Interest income	4,280	2,524
Total income	15,528	8,880
Expenses	(1,274)	(700)
Non-controlling interest [1]	(5,571)	(3,075)
Earnings for the period	$ 8,683	$ 5,105
Basic and diluted earnings per Fund unit	$ 1.06	$ .63
Distributable cash per Fund unit [2]	$ 1.08	$ .63
Distributions declared per Fund unit	$ 1.08	$ .63

Notes:

(1) Represents the effective interest of KRL in the earnings of the Fund.

(2) Distributable cash is not an earnings measure recognized by generally accepted accounting principles ("GAAP") and therefore may not be comparable to similar measures presented by other issuers. Distributable cash per Fund unit is computed on a basis consistent with that described by GAAP for computing earnings per Fund unit.

QUALITY, COMFORT AND VALUE ARE TIMELESS CONCEPTS.

At The Keg Steakhouse & Bar, these timeless attributes are manifested through our comfortable atmosphere, outstanding service and delicious steaks. The Keg has been around since 1971 and we've expanded to more than 85 locations across North America. For over 30 years, The Keg has delivered the winning combination of a truly satisfying restaurant experience combined with a bar that's an inviting destination of its own. Over the years we have perfected our tried and true recipe for creating an authentic steakhouse experience with an atmosphere that's friendly and a price that's affordable.

FUND CHAIRMAN'S REPORT TO UNITHOLDERS

On behalf of the Trustees of The Keg Royalties Income Fund (the "Fund"), I am pleased to present our second Annual Report. This report summarizes the Fund's first full fiscal year of operation since its IPO on May 31st, 2002.

ROYALTY INCOME FUND STRUCTURE

When the Fund was launched in May 2002, there were a number of key features which we believed would be attractive to Unitholders; this has in fact been the case.

The top-line nature of the Fund is foremost among these: the Fund's revenue is based solely on the top line revenues of Keg restaurants. The major operational expenses and capital expenditures associated with the restaurant business remain the responsibility of Keg Restaurants Ltd. ("KRL") and its franchisees, thereby eliminating those business risks to the Fund. The Fund has administrative and interest expenses of its own to manage on behalf of Unitholders, but they are relatively minor in relation to the Fund's revenues.

The Fund is also designed to ensure the interests of KRL and its management are aligned with the interests of the Fund – without requiring fees, incentives or other remuneration to achieve that alignment. KRL remained the largest investor in the Fund at January 1, 2004 with a fully diluted interest of 17.6%, up from 13.2% a year ago.

The financial and operational strength of KRL is of significant importance to the Fund as it is this underlying business which must pay the Royalties to the Fund. KRL remains a strong company, which continues to own and operate the majority of Keg restaurants. David Aisenstat, President & CEO of Keg Restaurants Ltd., will elaborate in his report to Unitholders.

REVIEW AND OUTLOOK

The challenges faced by the foodservice industry in 2003 are by now well known. While The Keg has not been immune to these challenges, total system sales continued to grow and once again reached a new record level for the year. Total system sales for The Keg for the 53 week period ended January 4, 2004 were $303,369,000 an increase of $20,497,000 or 7.2% over the 52 week period ended December 29, 2002.

The Keg's same store sales fell by 2.4% for the year. While these results are uncharacteristic for The Keg, they are not a pure indicator of restaurant traffic. Almost all of the decline is attributable to the unfavourable impact of the U.S. dollar exchange rate when translating the sales of the U.S. Keg restaurants into Canadian dollars for Fund reporting purposes. In fact, despite the combined impact of the SARS outbreak, the single case of BSE found in an Alberta cow, the August blackout in Eastern Canada, and the unparalleled decline in Canadian tourism expenditures, the decline in year-over-year restaurant traffic was less than 1% overall.

The foodservice industry has endured challenging back-to-back years in 2002 and 2003; 2003 in particular saw a "perfect storm" of challenging developments. The industry outlook for 2004 is much more positive and a return to the long-term growth that has characterized the foodservice industry over the past twenty-five years is expected.

RESULTS AS PROMISED

In spite of the challenging industry environment in which The Keg has operated, the Fund has continued to perform as expected. Each month since the Fund's inception Unitholders have received a distribution of 9¢ per unit. This is an

annualized rate of $1.08 per unit, which is slightly more than the $1.075 expected at the time of the Fund's IPO. Not only have there been no taxes payable within the Fund itself, but only 70% of the distributions have been taxable in the hands of Unitholders, with the balance being considered a return of capital.

Our royalty income fund structure has continued to serve Unitholders well, and we remain confident it will continue to do so. We are also confident that the management of KRL will continue to nurture and strengthen our valuable Keg brand, in the process, growing the business and increasing the Fund's Royalty Pool.

In closing, we would like to once again thank our Unitholders for the support demonstrated by their investment in The Keg Royalties Income Fund.

Sincerely,

C. C. Woodward
Chairman, The Keg Royalties Income Fund
on behalf of the Board of Trustees
March 31, 2004

KEG RESTAURANTS LTD. REPORT TO UNITHOLDERS

On behalf of Keg Restaurants Ltd., its management, franchisees and employees, I am pleased to present the audited financial statements of KRL for its fiscal year ended September 28, 2003.

THE KEG ROYALTIES INCOME FUND

On May 31, 2002, KRL sold the Keg Rights to the Fund. The Keg Rights are the trade marks, trade names, operating procedures and systems and other intellectual property used in connection with the operation of the Keg restaurants, and all goodwill associated therewith. KRL immediately entered into a Licence and Royalty Agreement with the Fund which gives KRL the exclusive licence to use the Keg Rights for a period of 99 years in exchange for a royalty payment of 4% of the sales of Keg restaurants in Canada and the U.S. KRL remains a private company which continues to operate the Keg restaurant business and owns the majority of the individual Keg restaurants. It is this underlying business which makes the monthly royalty payments to the Fund, which in turn distributes those monies to the Unitholders. Therefore, the financial results and operational expertise of KRL are of importance to Unitholders of the Fund. Please be assured that KRL and its Management are very mindful of this serious obligation to the Fund and govern ourselves accordingly.

RECORD SALES

As Mr. Woodward noted in his report to Unitholders, the foodservice industry has experienced difficult times over the past two years. Despite this, The Keg has once again enjoyed a year of record sales; this has been tempered somewhat by the same store sales decrease noted in the Fund Chairman's Report.

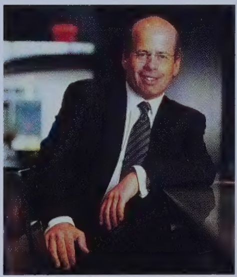
Through this difficult period, we feel The Keg has made some difficult but correct decisions. We have not compromised our product quality or quantity in any way; our strict specifications have remained fully intact. We have not reduced our staff levels, training programs or staff incentives in any way; we were once again recognized as one of the 50 Best Employers in Canada by the Globe & Mail's ROB magazine. We have not cut back the marketing programs which have built The Keg brand into the powerhouse it has become. While leaving all of these key elements intact, we also decided not to increase our menu prices on our usual schedule; the industry woes did not make this appropriate. Our guests have continued to enjoy the legendary Keg experience with legendary Keg value.

CONTINUED GROWTH

The Keg continues to grow. On January 1, 2004, the gross sales of seven new Keg restaurants which were opened in the period October 3, 2002 through October 2, 2003 were added to the Fund's Royalty Pool; two more Keg restaurants have opened since October 3, 2003, with several more under construction and in various stages of development. Some of these new restaurants are corporately owned by KRL; some are owned by franchisees. All of them have enjoyed successful openings and strong sales levels.

STEAKHOUSE FOCUS

We are proud of The Keg's continued prosperity and growth, especially against the backdrop of a challenging industry environment. It is particularly gratifying to have been the recipient of the 2003 Pinnacle Award for "Restaurant Company of the Year" as recognized by our peers. It is our belief that our continuing success is the result of maintaining a strong focus on one thing and one thing only: running great steakhouses and bars. There are some key



elements to this challenge, and a great many small issues which must be continually addressed, but we have an experienced and devoted leadership group at The Keg which we consider to be an invaluable asset. This group continues to provide the leadership and direction that keeps all our resources focused on running great steakhouses and bars.

A KEG SIZE® THANK YOU

I would like to conclude my remarks by thanking the many people who have contributed to The Keg's success over the past year: to the over ten million guests who visited The Keg, our suppliers and advisors who remain invaluable partners. But most of all, I would like to thank the 6,600 Keggers across Canada and the United States. It is this dedicated and spirited group that ensures these ten million guest visits are enjoyable and memorable, and that we will continue to earn the loyalty of our guests. So, not only to our Management and Administrative teams and to our Franchisees, but to each and every host, prepper, cook, busser, dishwasher, bartender and server – a Keg Size® toast and a Keg Size® thank you!

Sincerely,

David Aisenstat
President & CEO, Keg Restaurants Ltd.
March 31, 2004

WE BELIEVE A DISTINCT CULTURE IS AN INSPIRING ONE.

A fundamental key to The Keg's success is the quality of our employees. We hire the best, and we empower them with knowledge through our industry leading training programs. We encourage employees to develop their skills in a culture that presents many opportunities for professional and personal growth. Walk into any Keg across North America and you'll find Keggers to be outgoing, smiling, welcoming, with a genuine desire to please – Keg people have an

exceptional service style that's unique and famous. In 2003, for the second year in a row, The Keg Steakhouse & Bar was named by ROB Magazine as one of the "Top 50 Employers in Canada". As the only restaurant company

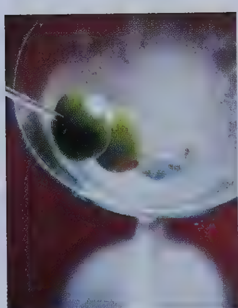
chosen for this employee-driven award, we are truly honored that the thousands of Keggers, who are the heart of The Keg, place such high value on the culture we foster.

WE DON'T HAVE CUSTOMERS,
WE HAVE GUESTS.

You'll never hear us refer to anyone who walks through our doors as a customer. They are always considered our guest. Typical Keg guests range in age from 18 - 44, have higher-than-average incomes, and are divided equally between men and women. The Keg Steakhouse & Bar avoids themes, schemes and short-lived trends. We provide exactly what our guests are looking for in a dining experience that's fun and inviting. It's an atmosphere that encourages people to relax and be themselves. The food is excellent and delivers quality and great value. Wherever they are located, Kegs are a home away from home, where customers are guests and where an inviting culture always welcomes you with a smile.

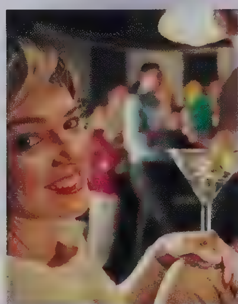
EVERYONE SHOULD HAVE THE CHANCE TO ENJOY THE PERFECT STEAKHOUSE EXPERIENCE.

Creating the perfect steakhouse means being an industry leader. A cornerstone of The Keg's success is the continual enhancement of our restaurants. Whether we are redesigning existing restaurants, relocating to better locations, or launching our proven methodology in new markets, our designs continue to evolve. Each restaurant is uniquely designed to best reflect its neighbourhood, while maintaining the overall look and feel The Keg is known for.

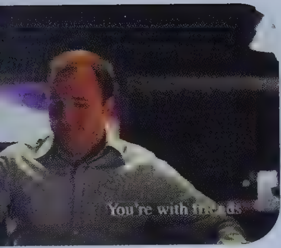


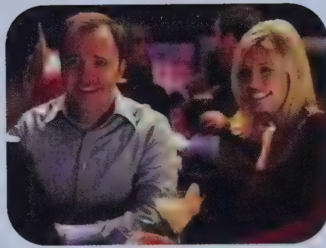
Originally inspired by The West Coast Ski Lodge design, The Keg design now incorporates a blend of traditional and contemporary. Consistent features include Cliff stone fireplaces, ironwork, cozy booths, rich woods and dramatic lighting. In the bar, the energy level is heightened with interesting artwork, hardwood floors and comfortable leather seating. All these materials come together in a welcoming and comfortable layout that provides the perfect gathering place for couples or crowds, business associates or best friends.

THE KEG BRAND CONTINUES TO BUILD WITH ONE CONSISTENT VOICE.



The Keg Steakhouse & Bar is a distinctive brand throughout North America. Our focus on being a great steakhouse is communicated within each restaurant and across all advertising and promotional material. Marketing programs are developed and implemented by The Keg's marketing department with the assistance of our advertising partners. All aspects of the marketing plan, from television advertising to local restaurant marketing, have a well-executed and consistent




message. National and regional television, billboards, magazine and newspaper are utilized to correspond with the needs of the marketplace. Using its marketing insight, The Keg serves up exciting promotions, such as the annual Lobster

Summer event, now in its 8th season. Lobster Summer offers guests additional variety and has been an overwhelming hit year after year. We continuously look for opportunities to deliver promotions that offer value to our guests.

THE KEG
ROYALTIES INCOME FUND

The Keg Royalties Income Fund (the "Fund") is an unincorporated open-ended limited purpose trust. It is listed on the Toronto Stock Exchange under symbol KEG.UN.

The Fund is the owner of the Keg Rights, a well-known and respected casual dining brand in Canada and the U.S. The Fund licenses Keg Restaurants Ltd. ("KRL") to use these rights and, in return, receives a royalty of 4% of system sales from Keg restaurants in the Royalty Pool, which currently has 86 restaurants. The Fund's income is based on the system sales of these restaurants and not bottom line profits; therefore, it is not subject to the variability of earnings or expenses associated with an operating business.

The Fund's only expenses are relatively minor administrative expenses, as well as interest on debt. No income or capital taxes are expected within the Fund, so the Fund's cash flow is distributed to Unitholders without deductions for these amounts. In 2002 and 2003, The Fund's monthly distributions to Unitholders were 9¢ per unit, which equals an annualized distribution of $1.08 per Fund unit. Approximately 30% of these distributions were a return of capital. For current information on The Keg Royalties Income Fund, including distributions and performance, please visit our website www.kegincomefund.com.

THE KEG ROYALTIES INCOME FUND

YEAR-END REPORT

For the year ended December 31, 2003

HIGHLIGHTS

($000's except earnings per unit amounts)	Jan. 1 to Dec. 31, 2003	May 31 to Dec. 31, 2002
Restaurants in the Royalty Pool	81	80
Gross sales reported by restaurants in the Royalty Pool	**$ 280,317**	**$ 157,547**
Royalty income	$ 11,248	$ 6,356
Interest income	4,280	2,524
Total income	**15,528**	**8,880**
Expenses	(1,274)	(700)
Non-controlling interest [1]	(5,571)	(3,075)
Earnings for the period	**$ 8,683**	**$ 5,105**
Basic and diluted earnings per Fund unit	**$ 1.06**	**$ .63**
Distributable cash per Fund unit [2]	**$ 1.08**	**$ .63**
Distributions declared per Fund unit	**$ 1.08**	**$ .63**

Notes:

(1) Represents the effective interest of KRL in the earnings of the Fund.

(2) Distributable cash is not an earnings measure recognized by generally accepted accounting principles ("GAAP") and therefore may not be comparable to similar measures presented by other issuers. Distributable cash per Fund unit is computed on a basis consistent with that described by GAAP for computing earnings per Fund unit.

MANAGEMENT DISCUSSION AND ANALYSIS

OVERVIEW

On May 31, 2002, The Keg Royalties Income Fund (the "Fund"), through its subsidiary The Keg Rights Limited Partnership (the "Partnership"), purchased The Keg trademarks and related property (collectively, the "Keg Rights") from Keg Restaurants Ltd. ("KRL"). The Partnership, in turn, granted KRL an exclusive licence to use the Keg Rights for a term of 99 years pursuant to a licence and royalty agreement. This agreement obligates KRL to make a monthly royalty payment equal to 4% of the gross sales of Keg restaurants in Canada and the United States.

The Fund's operating expenses are limited to administration expenses, interest on long-term debt and amortization of deferred financing fees.

KRL effectively owns 12.99% of the units of the Fund on a fully diluted basis through its ownership of Partnership units and has the obligation to pay monthly royalties to the Fund.

SYSTEM SALES

While the Fund's income is based on a royalty of 4% of sales of Keg restaurants in the Royalty Pool, the total system sales of The Keg chain are of interest to the Fund and its unitholders as the total system sales best reflect the chain's overall performance. The following table sets out The Keg's total system sales for the periods indicated below:

($000's)	53 weeks ended January 4, 2004	52 weeks ended December 29, 2002
Corporate Keg restaurants	$ 167,285	$ 163,568
Franchised Keg restaurants [1]	136,084	119,304
Total system sales	$ 303,369	$ 282,872

[1] The amount of system sales for the franchised Keg restaurants is the amount of gross sales reported to KRL by franchised Keg restaurants without verification by KRL and includes the gross sales of a joint venture restaurant located in Coquitlam, British Columbia.

KRL's year end falls on the Sunday closest to September 30th, in any year. As a result of the floating year-end date, approximately every fifth fiscal year contains 53 weeks of operation. KRL's fiscal year ending October 3, 2004 will contain 53 weeks of sales and related costs and the period ending January 4, 2004 will contain 14 weeks of sales and related costs.

Total system sales for the 53 weeks ended January 4, 2004 were $303.4 million compared to $282.9 million for the 52 weeks ended December 29, 2002, an increase of $20.5 million or 7.2%. System sales due to the extra week of operation were $5.5 million so, on a comparable basis, system sales increased by $15.0 million or 5.3%. During the 53 weeks ended January 4, 2004, six new restaurants were opened and two restaurants were closed. During the 52 weeks ended December 29, 2002, six new restaurants were opened and four restaurants were closed. As at January 4, 2004, there were a total of 88 Keg restaurants as compared with the 84 restaurants at December 29, 2002.

Same store sales (sales of restaurants that operated during the entire 53 week period of the current year and the 52 week period of the prior year) declined by 0.6%. After adjusting for the extra week of operation, same store sales for the comparable 52 week periods declined 0.2% in Canada and increased by 0.7% in the United States. After translating the sales of the U.S. restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 52 week periods declined by 2.4%. Almost all of this decrease is a function of the fluctuation of the U.S. dollar exchange rate rather than a decrease in actual restaurant traffic. The average exchange rate moved from 1.57 for fiscal 2002 to 1.40 for fiscal 2003, significantly reducing the Canadian dollar equivalent of the U.S. restaurant sales. Management attributes the balance of the same store sales declines to the combined impact of several factors: a general decline in travel and tourism due to the Iraq war and the increase in the value of the Canadian dollar; the SARS outbreak; the single case of BSE found in an Alberta cow; and the August blackout in Eastern Canada.

THE ROYALTY POOL

Annually, on January 1st, the pool of Keg restaurants on which KRL pays a royalty (the "Royalty Pool") to the Partnership is adjusted to include the gross sales from new Keg restaurants that have opened on or before October 2nd of the prior year, less gross sales from any Keg restaurants that have permanently closed during the year. In return for adding these net sales to the Royalty Pool, KRL receives the right to indirectly acquire additional Fund units (the "Additional Entitlement"). The Additional Entitlement is determined based on 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund units. KRL receives 80% of the estimated Additional Entitlement initially, with the balance received on December 31st each year when the actual full year performance of the new restaurants is known with certainty.

On January 1, 2003, three new Keg restaurants that opened during the period from April 1, 2002 through October 2, 2002 were added to the Royalty Pool. The actual gross sales of these three new restaurants were $13.2 million for the 52 weeks ended September 28, 2003. Two permanently closed Keg restaurants with annual sales of $3.8 million were removed from the Royalty Pool. This resulted in KRL receiving an Additional Entitlement equivalent to 310,815 Fund units effective as of January 1, 2003. The total number of restaurants in the Royalty Pool increased to 81. The yield of the Fund units was determined to be 11.25% calculated using a weighted average unit price of $9.60.

On January 1, 2004, seven new Keg restaurants that opened during the period from October 3, 2002 through October 2, 2003 were added to the Royalty Pool. The gross sales of these seven new restaurants have been estimated at $25.2 million annually. Two permanently closed Keg restaurants with annual sales of $4.6 million have been removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of $20.6 million annually. The total number of restaurants in the Royalty Pool has increased to 86. The yield of the Fund units was determined to be 11.66% calculated using a weighted average unit price of $9.26. As a result of the contribution of the additional net sales to the Royalty Pool, and assuming 100% of the estimated Additional Entitlement is received, KRL's Additional Entitlement will be equivalent to 653,193 Fund units, being 6.52% of the Fund units on a fully diluted basis. On January 1, 2004, KRL received 80% of this entitlement representing the equivalent of 522,554 Fund units, being 5.28% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2004 once the actual performance of the new restaurants has been confirmed. Including the initial portion of Additional Entitlement described above, KRL has the right to exchange its units in the capital of the Partnership for 1,739,314 Fund units, representing 17.58% of the Fund units on a fully diluted basis. If KRL were to receive 100% of the estimated Additional Entitlement for 2004, it would have the right to exchange its Partnership units for 1,869,952 Fund units, representing 18.66% of the Fund units on a fully diluted basis. All Fund units obtained by KRL in exchange for these Partnership units are subject to a contractual re-sale restriction, which expires on May 31, 2005.

The issued and outstanding units on a fully diluted basis of the Fund effective January 1, 2004 are as follows:

	Units	%
Owned by Public Unitholders:		
Fund Units	8,153,500	82.42
Owned by KRL:		
Class A Partnership Units	905,944	9.16
Class B Partnership Units	833,370	8.42
Total Partnership Units	1,739,314	17.58
Total issued and outstanding Units	9,982,814	100.00

OPERATING RESULTS

Readers should note that since the Fund commenced operations on May 31, 2002 year-to-date results are not directly comparable to the prior year. The year-to-date results for 2002 had only 215 operating days versus 365 operating days for 2003.

Gross sales reported by the restaurants in the Royalty Pool increased from $157,547,000 to $280,317,000. The increase reflects the net impact of the full year of operation in the current year, the extra week of sales due to KRL's reporting period cutoff, the addition of one net new restaurant to the Royalty Pool at the beginning of the year and the same store sales declines discussed above.

Royalty income increased by $4,892,000 from $6,356,000 in 2002 to $11,248,000 as a result of the increase in gross sales for the reasons explained above.

Operating expenses for the year ended December 31, 2003 were $1,274,000 and included general and administrative expenses of $442,000, interest on the long-term debt in the amount of $717,000 and amortization on the deferred financing charges of $115,000. General and administrative expenses increased by $218,000 over 2002 due primarily to the prior year only being a partial period, first time costs associated with the Annual General Meeting and the Annual Report as well as non-recurring costs associated with the development and implementation of a website. Interest costs have increased by $308,000 in the year, again due to the prior year only being a partial period and as a result of an increase in the average interest rate on the Fund debt from 4.8% in 2002 to 5.1% in 2003.

The non-controlling interest expense, which represents KRL's effective interest in the earnings of the Fund, has increased from $3,075,000 in 2002 to $5,571,000 in 2003. This increase is due to the prior year only being a partial period and KRL's increased effective ownership in the Fund from 10.0% to 12.99% as a result of the new store roll-in on January 1, 2003.

Net earnings increased by $3,578,000 from $5,105,000 in 2002 to $8,683,000 in 2003. Earnings per Fund unit were $1.06 compared to 63 cents in the prior year. Cash available for distribution during the year amounted to $1.08 per Fund unit versus the 63 cents per Fund unit available in the prior year. Distributions of $1.08 per Fund unit have been declared relative to this period in the current year versus 63 cents in the prior year. The difference between the Fund's earnings and distributable cash is due to non-cash items included in the Fund's operating expenses.

It is currently anticipated that the monthly distributions to unitholders will remain 9.0 cents per unit for the upcoming fiscal year, which equates to an annualized distribution of $1.08 per unit.

OUTLOOK

Following the challenging year the commercial foodservice industry experienced in 2002, it was widely expected that there would be a significant rebound in 2003. That was not the case, with the Canadian industry facing broader challenges than the U.S. The negative impact of the strong Canadian dollar hurt the tourism sector and both SARS and BSE took their toll. According to the Long Term Forecast of the Canadian Restaurant and Foodservices Association however, foodservice operators can look forward to a brighter 2004. Following an unprecedented two year decline in real foodservice sales, the forecast calls for sales in Canada's commercial foodservice industry to recover throughout 2004 and 2005 as tourism and global economies continue to improve. A return to real growth in the foodservice industry is predicted, with full service restaurants, the sector in which KRL operates, experiencing a particularly strong recovery.

OUTLOOK (CONTINUED)

KRL anticipates that it will record strong sales growth relative to the foodservice industry as a whole in the future, as it has historically. KRL remains committed to growth, both through expansion into new markets and same store sales increases. In addition to building new Kegs in both Canada and the U.S., KRL continues to refurbish, and in some cases relocate, existing Keg restaurants in order to better serve our guests and to protect and enhance the strong leadership position The Keg brand has enjoyed for over thirty years.

RISKS AND UNCERTAINTIES

The Fund continues to recognize certain risks and uncertainties associated with the ordinary course of business, including those associated with the business and operations of KRL, upon which the Fund relies solely for its income.

Management of KRL has advised the Trustees that it continues to monitor the situation regarding the two cases of BSE found in North America during 2003. The widespread testing of herds confirms these are isolated cases; the risk to human health appears to be negligible. Most importantly to The Keg, there has not been any significant negative consumer reaction to beef in North America and there has not been a material impact on its restaurant traffic. KRL management has further advised the Trustees that KRL has maintained an uninterrupted supply of quality beef that meets its demanding specifications despite the border closures and the unfortunate impact on cattle producers. Management of KRL expects the demand for beef to remain strong among consumers and its supply to continue uninterrupted.

FORWARD LOOKING INFORMATION

The information provided in this report includes forward-looking statements with respect to business plans, activities and events anticipated by the Fund and the Fund's future results. Although the Fund believes the assumptions underlying such statements to be reasonable, any of the assumptions may prove to be inaccurate and, as a result, the forward-looking information may prove to be incorrect. The forward-looking information contained in this document is current only as of the date of this document. There should not be an expectation that such information will in all circumstances be updated, supplemented or revised whether as a result of new information, changing circumstances, future events or otherwise.

MANAGEMENT'S STATEMENT OF RESPONSIBILITIES

The accompanying consolidated financial statements are the responsibility of management and have been reviewed and approved by the Board of Directors and the Trustees. The consolidated financial statements have been prepared by management, in accordance with Canadian generally accepted accounting principles and, where appropriate, reflect management's best estimates and judgements. Management has also prepared financial and all other information in the annual report and has ensured that this information is consistent with the consolidated financial statements.

The Fund maintains appropriate systems of internal control, policies and procedures, which provide management with reasonable assurance that assets are safeguarded and the financial records are reliable and form a proper basis for preparation of financial statements.

The Board of Directors and the Trustees ensure that management fulfills its responsibilities for financial reporting and internal control through an Audit Committee. The committee reviews the consolidated financial statements and reports to the Trustees. The auditors have full and direct access to the Audit Committee.

The consolidated financial statements have been independently audited by KPMG LLP, in accordance with Canadian generally accepted accounting standards. Their report following this statement expresses their opinion on the consolidated financial statements of the Fund.

C.C. Woodward
Chairman, The Keg Royalties Income Fund
on behalf of the Board of Trustees

AUDITORS' REPORT TO THE UNITHOLDERS OF THE KEG ROYALTIES INCOME FUND

We have audited the consolidated balance sheets of The Keg Royalties Income Fund as at December 31, 2003 and 2002 and the consolidated statements of earnings, unitholders' equity and cash flows for the periods then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the periods then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Vancouver, Canada

January 23, 2004

CONSOLIDATED BALANCE SHEETS

(Expressed in thousands of dollars)

	December 31, 2003	December 31, 2002
ASSETS		
Current assets:		
Accounts receivable	$ -	$ 1
Due from Keg Restaurants Ltd. (note 6)	1,633	1,558
Prepaid expenses and deposits	35	25
	1,668	1,584
Note receivable from Keg Restaurants Ltd. (note 7)	57,000	57,000
Intangible assets (note 8)	113,547	113,547
Deferred financing charges	163	278
	$ 172,378	$ 172,409
LIABILITIES AND UNITHOLDERS' EQUITY		
Current liabilities:		
Bank indebtedness (note 9)	$ 197	$ 40
Accounts payable and accrued liabilities	198	315
Interest payable on term loan	7	7
Distributions payable to Fund unitholders	734	734
Distributions payable to non-controlling interest	541	460
	1,676	1,556
Term loan (note 10)	14,000	14,000
Non-controlling interest (note 11)	83,021	83,050
Unitholders' equity	73,680	73,803
	$ 172,378	$ 172,409

Subsequent event (note 15)

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board of Trustees

C.C. Woodward, Trustee

George Tidball, Trustee

CONSOLIDATED STATEMENTS OF EARNINGS

(Expressed in thousands of dollars, except per unit amounts)

	Year ended December 31, 2003	May 31 to December 31, 2002
Gross sales reported by Keg restaurants in the Royalty Pool (note 3)	$ 280,317	$ 157,547
Revenue:		
Royalty income (note 3)	$ 11,248	$ 6,356
Interest income	4,280	2,524
	15,528	8,880
Expenses:		
General and administrative	442	224
Interest and financing fees	717	409
Amortization of deferred financing charges	115	67
	1,274	700
Earnings before non-controlling interest	14,254	8,180
Non-controlling interest (note 11)	5,571	3,075
Net earnings for the period	$ 8,683	$ 5,105
Basic and diluted earnings per Fund Unit (8,153,500 units)	$ 1.06	$ 0.63

CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY

(Expressed in thousands of dollars)

	Year ended December 31, 2003	May 31 to December 31, 2002
Balance, beginning of period	$ 73,803	$ -
Issue of Fund Units, net of issue costs (note 12)	-	73,835
Net earnings	8,683	5,105
Distributions declared to Fund unitholders	(8,806)	(5,137)
Balance, end of period	$ 73,680	$ 73,803

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars)

	Year ended December 31, 2003	May 31 to December 31, 2002
Cash provided by (used for):		
OPERATIONS:		
Net earnings for the period	$ 8,683	$ 5,105
Items not involving cash:		
Amortization of deferred financing charges	115	67
Non-controlling interest	5,571	3,075
Change in non-cash operating working capital (note 14(a))	(201)	(1,262)
	14,168	6,985
INVESTMENTS:		
Acquisition of Keg Rights (note 8)	-	(30,488)
Note receivable from Keg Restaurants Ltd. (note 7)	-	(57,000)
	-	(87,488)
FINANCING:		
Distributions paid to Fund unitholders	$ (8,806)	(4,403)
Distributions paid to non-controlling interest	(5,519)	(2,624)
Issuance of Fund Units	-	81,535
Costs of issuance of Fund Units	-	(7,700)
Proceeds from term loan	-	14,000
Deferred financing charges	-	(345)
	(14,325)	80,463
Increase in bank indebtedness	(157)	(40)
Bank indebtedness, beginning of period	(40)	-
Bank indebtedness, end of period	$ (197)	$ (40)

See note 14(b) for supplementary cash flow information.
See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the year ended December 31, 2003

1. ORGANIZATION AND NATURE OF BUSINESS:

The Keg Royalties Income Fund (the "Fund") is an unincorporated open-ended limited purpose trust established under the laws of Ontario with the authority to issue an unlimited number of Trust Units ("Units'). The Fund was established to invest in The Keg Rights Limited Partnership (the "Partnership"), which owns the trademarks, trade names, operating procedures and systems and other intellectual property (collectively, the "Keg Rights") used in connection with the operation of Keg Steakhouse and Bar restaurants. Pursuant to the Declaration of Trust of the Fund, an amount equal to all income of the Fund, together with the non-taxable portion of any net capital gain realized by the Fund, will be distributed by the Fund to its unitholders each year. As a result, the Fund will generally not be liable for income taxes. Income tax obligations related to the distributions by the Fund are obligations of the unitholders.

The business of the Partnership is the ownership of the Keg Rights and through a Licence and Royalty Agreement (the "Licence and Royalty Agreement") with Keg Restaurants Ltd. ("KRL") to exploit the use of the Keg Rights and the collection of the Royalty payable under the Licence and Royalty Agreement. KRL's principal activity is the operation and franchising of Keg Steakhouse and Bar restaurants in Canada and the United States.

2. SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of presentation:

These consolidated financial statements include the accounts of The Keg Royalties Income Fund, its wholly-owned subsidiary The Keg Holdings Trust ("KHT"), its 90% owned subsidiary The Keg GP Ltd. ("KGP") and the Partnership (collectively, the "Companies"). The KGP is the managing general partner of the Partnership. All residual ownership of the Companies is either directly or indirectly controlled by KRL and has been recorded as non-controlling interest.

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. As there were no material transactions during the period from establishment on April 12, 2002 to the commencement of operations on May 31, 2002, the comparative balances shown are for the period from May 31, 2002 to December 31, 2002.

All significant intercompany transactions have been eliminated.

(b) Revenue recognition:

Royalty revenue is equal to four percent of gross sales of specific Keg Steakhouse and Bar restaurants in Canada and the United States, and is recognized on an accrual basis for four or five week periods, depending on the number of weeks in the corresponding KRL reporting period.

Interest revenue is recognized and accrued for when earned.

For the year ended December 31, 2003

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(c) Intangible assets:

Intangible assets consisting of Keg Rights are recorded at cost. The Keg Rights are not amortized as they have an indefinite life. Management of the Fund reviews the carrying value for the intangible assets at least annually, taking into consideration any events or circumstances which might have impaired the carrying value. If a permanent decline in the carrying amount is determined, the intangible assets are written down to their estimated net recoverable amount.

(d) Deferred financing charges:

Deferred financing charges relate to the term loan and are amortized on a straight-line basis over the three-year term of the loan.

(e) Distributions to Fund unitholders:

The amount of cash to be distributed to Fund unitholders is determined with reference to distributable cash, which is calculated as net earnings adjusted for amortization, non-controlling interest, repayment of principal and interest on term loans and distributions by the Partnership to the holder of the non-controlling interest.

Distributions to Fund unitholders are made monthly, based upon distributable cash less redemptions of Fund Units, and are subject to the Fund retaining such reasonable working capital reserves as may be considered appropriate by the Trustees of the Fund.

(f) Earnings per Fund Unit:

The earnings per Fund Unit are based on the weighted average number of Fund Units outstanding during the period. Diluted earnings per Fund Unit are calculated to reflect the dilutive effect of the holder of the non-controlling interest exercising its right to exchange its Class A and Class B Units of the Partnership into Fund Units.

(g) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination of impairment in the value of assets, useful lives for amortization and provisions for contingencies. Actual results could differ from those estimates.

(Tabular amounts expressed in thousands of dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(h) Financial instruments:

The Fund's financial instruments consist of cash, accounts receivable, note receivable, accounts payable and accrued liabilities and the term loan. Management estimates that the fair values of these financial instruments approximate their carrying values. It is management's opinion that the Fund is not exposed to significant interest or credit risks arising from these financial instruments.

(i) Economic dependence:

The Partnership and the Fund are each entirely dependent upon the operations and assets of KRL to pay the royalty and make-whole payments to the Partnership and the interest payments to the Fund. Accordingly, each is subject to the risks encountered by KRL in the operation of its business.

3. GROSS SALES:

The gross sales reported by the 81 Keg restaurants (2002 - 80 Keg restaurants) on which KRL pays a royalty (the "Royalty Pool") are from January 1, 2003 to December 31, 2003 and from May 31, 2002 (commencement of operations) to December 31, 2002.

The royalty payment from KRL to the Partnership is four percent of system sales for such period reported by Keg restaurants in the Royalty Pool plus a make-whole payment, if required by a restaurant closure, based on four percent of lost system sales. System sales for any period and for any Keg restaurant located in Canada and the United States, as defined in the Licence and Royalty Agreement, means the gross sales by such Keg restaurants for such period. Lost system sales, in respect of any Keg restaurant that has permanently closed during such period, means an amount based on the amount of system sales for such restaurant during the Initial Keg Restaurant Period for the 52 weeks ended March 31, 2002. The make-whole payment is based on two restaurant closures for the period from January 1, 2003 to December 31, 2003 (May 31, 2002 to December 31, 2002 - two restaurant closures).

	Year ended December 31, 2003	May 31 to December 31, 2002
System sales reported by Keg restaurants in the Royalty Pool	$ 280,317	$ 157,547
Royalty income at 4% of system sales reported above	11,213	6,301
Make-whole payment, based on 4% of lost system sales	35	55
Total royalty income	$ 11,248	$ 6,356

(Tabular amounts expressed in thousands of dollars)

4. THE ROYALTY POOL:

Annually, on January 1, the Keg restaurants in the Royalty Pool on which KRL pays a royalty to the Partnership is adjusted to include the gross sales from new Keg restaurants opened on or before October 2 of the prior year, less gross sales from any Keg restaurants that have permanently closed during the year. In return for adding these net sales to the Royalty Pool, KRL will receive the right to indirectly acquire additional Fund Units (the "Additional Entitlement"). The Additional Entitlement is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund Units. KRL receives 80% of the Additional Entitlement initially, with the balance received when the actual full year performance of the new restaurants is known with certainty.

On January 1, 2003, three new Keg restaurants that opened during the period from April 1, 2002 through October 2, 2002 were added to the Royalty Pool. The actual gross sales of these three new restaurants were $13.2 million for the 52 weeks ended September 28, 2003. Two permanently closed Keg restaurants with annual sales of $3.8 million were removed from the Royalty Pool. This resulted in KRL receiving an Additional Entitlement equivalent to 310,815 Fund Units effective as of January 1, 2003. The total number of restaurants in the Royalty Pool increased to 81. The yield of the Fund Units was determined to be 11.25% calculated using a weighted average unit price of $9.60.

5. DISTRIBUTABLE CASH:

	Year ended December 31, 2003	May 31 to December 31, 2002
Earnings for the period	$ 8,683	$ 5,105
Amortization of deferred financing charges	115	67
Non-controlling interest	5,571	3,075
	14,369	8,247
Distributable cash required for non-controlling interest	(5,600)	(3,084)
Distributable cash available for Fund unitholders	$ 8,769	$ 5,163
Distributions declared to Fund unitholders (8,153,500 Units)	$ 8,806	$ 5,137

Distributable cash is not an earnings measure recognized by generally accepted accounting principles ("GAAP") and therefore may not be comparable to similar measures presented by other issuers.

(Tabular amounts expressed in thousands of dollars)

For the year ended December 31, 2003

6. DUE FROM KEG RESTAURANTS LTD.:

	December 31, 2003	December 31, 2002
Royalty fee, including GST	$ 1,270	$ 1,195
Interest on note receivable from Keg Restaurants Ltd.	363	363
	$ 1,633	$ 1,558

The above amounts were received when due from KRL subsequent to year end to facilitate the January distribution to Fund unitholders.

7. NOTE RECEIVABLE FROM KEG RESTAURANTS LTD.:

	December 31, 2003	December 31, 2002
Note receivable with interest payable monthly at 7.5% per annum and principal amount due May 31, 2042	$ 57,000	$ 57,000

The note is secured by a general security agreement and may not be assigned without the prior consent of KRL.

8. ACQUISITION OF KEG RIGHTS:

On May 31, 2002, the Partnership, a subsidiary of the Fund, acquired the Keg Rights from KRL for $113,546,820 of which $30,487,380 was paid in cash, $9,059,440 was paid by the issuance of 905,944 Class A Partnership Units ("Class A Units"), $17,000,000 was paid by the issuance of 3,376,700 Class B Partnership Units ("Class B Units") and $57,000,000 was paid by the issuance of 5,700,000 Class C Partnership Units ("Class C Units").

Concurrently with the acquisition of the Keg Rights, the Partnership granted KRL a licence to use the Keg Rights for a term of 99 years for which KRL pays the Partnership a royalty of four percent of the system sales reported by KRL for restaurants included in the Royalty Pool (note 3).

9. OPERATING LINE OF CREDIT:

The Fund has a demand operating facility of up to $2,000,000 to fund the Partnership's working capital requirements and for general purposes. The facility bears interest at bank prime plus 0.25% and is repayable on demand. As at December 31, 2003, $1,778,831 (December 31, 2002 - $1,951,188) of the facility was available. The facility is collateralized as part of the Term Loan (note 10).

10. TERM LOAN:

The Fund has a term loan in the amount of $14,000,000. The facility bears interest at bank prime plus 0.375% and matures on May 31, 2005. A general security agreement over the assets of the Fund is provided as security.

(Tabular amounts expressed in thousands of dollars)

11. NON-CONTROLLING INTEREST:

	December 31, 2003	December 31, 2002
Balance, beginning of period	$ 83,050	$ -
Issuance of Class A Partnership Units	-	9,059
Issuance of Class B Partnership Units	-	17,000
Issuance of Class C Partnership Units	-	57,000
Non-controlling interest in earnings of the Partnership	5,571	3,075
Distributions declared to non-controlling interest	(5,600)	(3,084)
Balance, end of period	$ 83,021	$ 83,050

The Class A Units are entitled to a preferential proportionate distribution equal to the distribution on the Class C Units, multiplied by the number of Class A Units divided by the number of Limited Partnership Units ("LP Units") issued and outstanding. KHT holds all of the 8,153,500 LP Units issued and outstanding at December 31, 2003. The LP Units are eliminated upon consolidation of the Fund. In addition, the Class A Units receive a residual distribution proportionately with the Class B Units, LP Units and General Partnership Units relative to the aggregate number of each class issued and outstanding (or in the case of the Class B Units, the number issued and outstanding multiplied by the Class B current distribution entitlement). Class A Units are exchangeable for Fund Units on the basis of one Fund Unit for one Class A Unit.

The Class B Units are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership from new Keg restaurants. The distribution entitlements of the Class B Units are adjusted annually on January 1 beginning in January 2003. Class B Units are exchangeable for Fund Units based upon a defined calculation that itself is based on system sales from new restaurants. As at December 31, 2003, 310,815 (December 31, 2002 - nil) Class B Units receive a distribution entitlement and may be exchanged for Fund Units.

The Class C Units are entitled to a preferential monthly distribution equal to $0.0625 per Class C Unit issued and outstanding. KRL, the holder of the Class C Units, has the right to transfer Class C Units to KHT, in consideration for the assumption by KHT of an amount of the note receivable from KRL equal to $10.00 per Class C Unit transferred.

All Fund Units obtained by KRL in exchange for the above Partnership Units are subject to a contractual re-sale restriction, which expires on May 31, 2005.

12. UNITHOLDERS' EQUITY:

The Declaration of Trust of the Fund provides that an unlimited number of Fund Units may be issued. Each Fund Unit is transferable and represents an equal undivided beneficial interest in any distributions of the Fund and in the net assets of the Fund. All Units have equal rights and privileges. Each Fund Unit entitles the holder thereof to participate equally in the allocations and distributions and to one vote at all meetings of Fund unitholders for each whole Fund Unit held. The Fund Units issued are not subject to future calls or assessments.

(Tabular amounts expressed in thousands of dollars)

12. UNITHOLDERS' EQUITY (CONTINUED):

Pursuant to the Declaration of Trust, the holder (other than the Fund or its subsidiaries) of the Class A Units and Class B Units are entitled to vote in all votes of Fund unitholders as if they were holders of the number of Fund Units they would receive if Class A Units and Class B Units were exchanged into Fund Units as of the record date of such votes, and will be treated in all respects as Fund unitholders for the purpose of any such votes.

Fund Units are redeemable at any time at the option of the holder at a price based on market value as defined in the trust agreement, subject to a maximum of $50,000 in cash redemptions by the Fund in any one month. The limitation may be waived at the discretion of the Trustees of the Fund. Redemption in excess of these amounts, assuming no waiving of the limitation, shall be paid by way of a pro-rata distribution of Partnership securities held by the Fund.

On May 31, 2002, the Fund issued 8,153,500 fund Units at $10.00 per Unit pursuant to a public underwriting. Expenses of the offering amounted to $7,700,000 and were charged to Fund unitholders' equity.

13. ADMINISTRATION AGREEMENT:

The Fund has entered into an administrative agreement with its subsidiary, the Partnership, whereby the Partnership will provide or arrange for the provision of services required in the administration of the Fund. In turn, the Partnership has arranged for certain of these services to be provided by KRL in its capacity as a partner of the Partnership. For the period for January 1, 2003 to December 31, 2003, KRL provided these services at no cost to the Partnership.

14. SUPPLEMENTARY CASH FLOW INFORMATION:

	Year ended December 31, 2003	May 31 to December 31, 2002
(a) Change in non-cash operating working capital:		
Accounts receivable	$ 1	$ (1)
Due from Keg Restaurants Ltd. (note 6)	(75)	(1,558)
Prepaid expenses and deposits	(10)	(25)
Accounts payable and accrued liabilities	(117)	315
Interest payable	-	7
	$ (201)	$ (1,262)

(Tabular amounts expressed in thousands of dollars)

14. SUPPLEMENTARY CASH FLOW INFORMATION (CONTINUED):

	Year ended December 31, 2003	May 31 to December 31, 2002
(b) Supplementary information:		
Interest received	$ 4,280	$ 2,161
Interest paid	717	401
Non-cash transactions:		
Acquisition of the Keg Rights in exchange for the following:		
Class A Partnership Units	-	9,059
Class B Partnership Units	-	17,000
Class C Partnership Units	-	57,000

15. SUBSEQUENT EVENT:

On January 1, 2004, seven new Keg restaurants that opened during the period from October 3, 2002 through October 2, 2003 were added to the Royalty Pool. The gross sales of these seven new restaurants have been estimated at $25.2 million annually. Two permanently closed Keg restaurants with annual sales of $4.6 million have been removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of $20.6 million annually. The total number of restaurants in the Royalty Pool has increased to 86. The yield of the Fund Units was determined to be 11.66% calculated using a weighted average unit price of $9.26.

As a result of the contribution of the additional net sales to the Royalty Pool, and assuming 100% of the estimated Additional Entitlement is received, KRL's Additional Entitlement will be equivalent to 653,193 Fund Units, being 6.52% of the Fund Units on a fully diluted basis. On January 1, 2004, KRL received 80% of this entitlement representing the equivalent of 522,554 Fund Units, being 5.28% of the Fund Units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the initial portion of the Additional Entitlement described above, KRL has the right to exchange its Units in the capital of the Partnership for 1,739,314 Fund Units, representing 17.58% of the Fund Units on a fully diluted basis. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2004 once the actual performance of the new restaurants have been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2004, it would have the right to exchange its Partnership Units for 1,869,952 Fund Units, representing 18.66% of the Fund Units on a fully diluted basis. All Fund Units obtained by KRL in exchange for these Partnership Units are subject to a contractual re-sale restriction, which expires on May 31, 2005.

KEG RESTAURANTS LTD.

YEAR-END REPORT

For the 52 weeks ended September 28, 2003

Provided as a supplement to the financial statements of The Keg Royalties Income Fund.

FINANCIAL HIGHLIGHTS

The following table sets out selected financial information and other data of Keg Restaurants Ltd. ("KRL"), which should be read in conjunction with the attached audited, consolidated financial statements of KRL for the 52 weeks ended September 28, 2003.

SELECTED FINANCIAL INFORMATION OF KRL

	52 weeks ended September 28, 2003	52 weeks ended September 29, 2002
	(in thousands of dollars)	
System sales [1]	$ 291,877	$ 276,994
Corporate restaurant sales [2]	$ 163,934	$ 162,375
Retail operating contribution (loss) [3]	$ (271)	$ 126
Franchise fee income	6,037	5,307
Operating costs and expenses	(157,983)	(154,053)
Operating earnings	$ 11,717	$ 13,755
Equity income [4]	5,457	1,767
Royalty fee expense	(10,958)	(3,628)
Executive bonus [5]	-	(2,410)
EBITDA [6]	$ 6,216	$ 9,484

Notes:

(1) Represents the gross sales of all restaurants owned by KRL and the gross sales reported to KRL by franchised Keg restaurants without independent audit.

(2) Includes gross sales for all restaurants owned by KRL and its proportionate share of gross sales from a joint venture restaurant located in Coquitlam, BC.

(3) Represents the revenue net of related expenses of a wholly owned subsidiary, which sells Keg branded food and liquor products.

(4) Represents the equity income from KRL's investment in The Keg Rights Limited Partnership and its 12.6% (2002 - 10.0%) effective interest in The Keg Royalties Income Fund, which began on May 31, 2002.

(5) The Executive bonus is a discretionary expense which is applicable to the CEO, who is also the sole shareholder of KRL, and is based on several criteria including the profitability of KRL.

(6) EBITDA is earnings before amounts for interest, taxes, depreciation and amortization, loss on disposal of property, plant and equipment and long term debt settlement expenses. EBITDA is not a recognized measure under Canadian Generally Accepted Accounting Principles.

MANAGEMENT DISCUSSION AND ANALYSIS

OVERVIEW

Keg Restaurants Ltd. ("KRL") is the owner/operator and franchisor of casual dining steakhouse restaurants operating under the trade name "The Keg Steakhouse & Bar" in Canada and select markets in the United States. The revenue of KRL is derived from sales from corporate Keg restaurants, its proportionate share of a joint venture Keg restaurant, franchise fee income and revenue from sales of food and liquor products marketed under the Keg brand name. Sales from corporate Keg restaurants are affected by the number of new corporate Keg restaurants that are opened or closed. Franchise fee income is affected by the amount of sales generated by existing franchised Keg restaurants and the number of franchised Keg restaurants that are opened or closed.

Operating costs and expenses include food and beverage costs, premises costs, and labour costs of corporate Keg restaurants, marketing and advertising expenses net of franchisee contributions, as well as general and administrative costs associated with the operations of KRL in providing services to the corporate and franchised Keg restaurants.

On May 31, 2002, KRL completed a transaction in which KRL sold the Keg trademarks and related property (collectively, the "Keg Rights") to The Keg Rights Limited Partnership (the "Partnership"), a subsidiary of The Keg Royalties Income Fund (the "Fund"). The Partnership in turn licensed the use of these Keg Rights to KRL under a licence and royalty agreement for a term of 99 years. KRL pays the Partnership a royalty of 4% of system sales (the "Royalty"). The Royalty was initially based on the 80 Keg restaurants in existence on March 31, 2002.

Annually, on January 1st, the pool of Keg restaurants on which KRL pays a royalty to the Partnership (the "Royalty Pool") is adjusted to include the gross sales from new Keg restaurants that have opened on or before October 2nd of the prior year, less gross sales from any Keg restaurants that have permanently closed during the year. In return for adding these net sales to the Royalty Pool, KRL receives the right to indirectly acquire additional Fund units (the "Additional Entitlement"). The Additional Entitlement is determined based on 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund units. KRL receives 80% of the estimated Additional Entitlement initially, with the balance received on December 31st each year when the actual full year performance of the new restaurants is known with certainty.

On January 1, 2003, three new Keg restaurants that opened during the period from April 1, 2002 through October 2, 2002 were added to the Royalty Pool. The actual gross sales of these three new restaurants were $13.2 million for the 52 weeks ended September 28, 2003. Two permanently closed Keg restaurants with annual sales of $3.8 million were removed from the Royalty Pool. This resulted in KRL receiving an Additional Entitlement equivalent to 310,815 Fund units effective as of January 1, 2003. The total number of restaurants in the Royalty Pool increased to 81. The yield of the Fund units was determined to be 11.25% calculated using a weighted average unit price of $9.60.

On January 1, 2004, seven new Keg restaurants that opened during the period from October 3, 2002 through October 2, 2003 were added to the Royalty Pool. The gross sales of these seven new restaurants have been estimated at $25.2 million annually. Two permanently closed Keg restaurants with annual sales of $4.6 million have been removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of $20.6 million annually. The total number of restaurants in the Royalty Pool has increased to 86. The yield of the Fund units was determined to be 11.66% calculated using a weighted average unit price of $9.26. As a result of the contribution of the additional net sales to the Royalty Pool, and assuming 100% of the estimated Additional Entitlement is received, KRL's Additional Entitlement will be equivalent to 653,193 Fund units, being 6.52% of the Fund units on a fully diluted basis.

OVERVIEW (CONTINUED)

On January 1, 2004, KRL received 80% of this entitlement representing the equivalent of 522,554 Fund units, being 5.28% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the initial portion of the Additional Entitlement described above, KRL has the right to exchange its units in the capital of the Partnership for 1,739,314 Fund units, representing 17.58% of the Fund units on a fully diluted basis. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2004 once the actual performance of the new restaurants have been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2004, it would have the right to exchange its Partnership units for 1,869,952 Fund units, representing 18.66% of the Fund units on a fully diluted basis. All Fund units obtained by KRL in exchange for these Partnership units are subject to a contractual re-sale restriction, which expires on May 31, 2005.

OPERATING RESULTS

System sales for the 52 weeks ended September 28, 2003 were $291,877,000 compared to $276,994,000 for the 52 weeks ended September 29, 2002, an increase of $14,883,000 or 5.4%. During the 52 weeks ended September 28, 2003, two new corporate restaurants and four new franchised restaurants were opened and one franchised restaurant was closed. During the prior year, three new corporate restaurants and five new franchised restaurants were opened, and three corporate restaurants and four franchised restaurants were closed. As at September 28, 2003, there were a total of 86 restaurants as compared with the 81 restaurants at September 29, 2002.

Same store sales (sales of restaurants that operated during the entire 52 week period of both the current and the prior year) declined by 2.1%. Almost three quarters of this decrease is a function of the fluctuation of the U.S. dollar exchange rate rather than a decrease in actual restaurant traffic. The average exchange rate moved from 1.57 for fiscal 2002 to 1.47 for fiscal 2003, significantly reducing the Canadian dollar equivalent of the U.S. restaurant sales. Management attributes the balance of the same store sales declines, which were less than 1%, to the combined impact of several factors: a general decline in travel and tourism due to the Iraq war and the increase in the value of the Canadian dollar; the SARS outbreak; the single case of BSE found in an Alberta cow; and the August blackout in Eastern Canada.

Retail operating contribution (revenue net of related expenses of a wholly owned subsidiary which sells Keg branded food and liquor products) decreased from a profit in the prior year of $126,000 to a loss in the current year of $271,000. The decrease resulted primarily from additional marketing and advertising expenses of $145,000 related to the promotion of a Keg branded liquor product, and other adjustments to the retail product portfolio.

Franchise fee income climbed from $5,307,000 during the prior year to $6,037,000 during the current year, an increase of $730,000 or 13.8%. This increase resulted from additional franchise fees from one franchised restaurant that opened towards the end of the prior year, two franchised restaurants that opened during the current year and two relocated franchised restaurants.

Operating costs and expenses for the current year increased to $157,983,000 from $154,053,000 for the prior year. The increase of $3,930,000 was primarily due to six expense categories. Restaurant variable operating costs increased by $1,107,000 due to the increased sales for the period. Food costs increased by $2,040,000 primarily as a result of significantly higher beef prices than in the prior year, particularly in the United States, which were due to the partial closure of the U.S. border to Canadian beef. Labour costs increased by $695,000 due to wage rate changes at both the staff and assistant manager levels. Restaurant fixed costs increased by $1,395,000 due to increased facility costs related to two additional corporate restaurants and significantly higher insurance and utility costs. General and administrative expenses, which include marketing and advertising expenses as well as corporate administrative expenses, decreased by $1,499,000 for the year. Marketing and advertising expenditures decreased by $728,000 partly due to increased contributions from franchisees, and partly due to a non-recurring investment spend in two expansion markets in the United States in the prior year.

OPERATING RESULTS (CONTINUED)

Furthermore, additional monies spent on promotions at the restaurant level replaced some corporate advertising in the major media. Corporate administrative expenses decreased by $736,000 partly as a result of a reduction in bonus expense to corporate managers, and as a result of the favourable settlement of a non-Keg lease guarantee obligation in the amount of $500,000, of which $410,000 has been included in income in the current year to offset expenses actually incurred.

Operating earnings decreased by $2,038,000 from $13,755,000 for the 52 weeks ended September 29, 2002 to $11,717,000 for the 52 weeks ended September 28, 2003 due to the cost increases noted above. Management views operating earnings as a key figure as it indicates the funds generated by KRL which are available to meet its royalty payment obligations to the Fund, interest and income tax obligations, and to pay any discretionary expenses.

As the Fund commenced operations on May 31, 2002, investment income and royalty expense for the current year are not directly comparable to the prior year. Investment income from KRL's effective interest in the Fund amounted to $5,457,000 (2002 - $1,767,000) and the royalty expense paid for the use of the Keg Rights totalled $10,958,000 (2002 - $3,628,000) during the 52 weeks ended September 28, 2003, resulting in a net expense of $5,501,000 (2002 - $1,861,000). These figures do not include interest of $4,263,000 (2002 - $1,429,000) on the $57,000,000 note payable to the Fund, which has been included in interest expense for the year.

EBITDA for the 52 weeks ended September 28, 2003 was $6,216,000 compared to $9,484,000 for the prior year. The decline in EBITDA of $3,268,000 for the year is due to the net impact of the decrease in operating earnings of $2,038,000, the increase of $3,640,000 in net expenses related to the Fund, as explained above and the absence of an Executive bonus in the current fiscal year.

The net loss before taxes for fiscal 2003 amounted to $5,858,000 compared to a net loss of $14,068,000 during fiscal 2002. The loss in the prior year was mainly due to costs associated with the early repayment of long-term debt.

LIQUIDITY AND CAPITAL RESOURCES

KRL received $87,487,000 in cash on completion of the Fund's initial public offering in May 2002. This cash was used as follows:

	(in thousands of dollars)
Cash retained in cash collateral account	$ 750
Retirement of Canadian long-term debt	45,750
Payment of debt settlement expenses	11,206
Investment in restaurant expansion	17,003
Payment of dividends	12,778
	$ 87,487

KRL must invest in the maintenance of the corporate Keg restaurants on an annual basis and it is estimated that the costs of these maintenance capital expenditures is $2,300,000 per annum.

KRL will use cash flow from operations to fund seasonal fluctuations in working capital and maintenance capital expenditures. Management plans to continue to utilize traditional bank financing to fund the opening of new corporate Keg restaurants in Canada. Subsequent to KRL's fiscal year end, certain Canadian expansion costs incurred in the prior year have been financed in this manner as noted below. Management further anticipates additional loan facilities for the expansion of corporate Keg restaurants in the United States on similar terms and conditions as exist currently, and financing in this regard was also completed subsequent to KRL's fiscal year end, also as noted below.

LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

On September 30, 2003, KRL entered into a CDN$5,250,000 credit facility agreement with a major Canadian chartered bank. This secured facility includes a demand loan in the amount of $4,000,000, the proceeds of which have been used solely for the expansion of restaurant operations in Canada and a maximum of $1,250,000 available for outstanding letters of credit. Subsequent to September 28, 2003, KRL's wholly owned subsidiary, Keg Restaurants U.S., Inc., obtained secured debt financing in the amount of US$3,500,000 for expansion of U.S. restaurant operations.

OUTLOOK

Following the challenging year the commercial foodservice industry experienced in 2002, it was widely expected that there would be a significant rebound in 2003. That was not the case, with the Canadian industry facing broader challenges than the U.S. The negative impact of the strong Canadian dollar hurt the tourism sector and both SARS and BSE took their toll. According to the Long Term Forecast of the Canadian Restaurant and Foodservices Association however, foodservice operators can look forward to a brighter 2004. Following an unprecedented two year decline in real foodservice sales, the forecast calls for sales in Canada's commercial foodservice industry to recover throughout 2004 and 2005 as tourism and global economies continue to improve. A return to real growth in the foodservice industry is predicted, with full service restaurants, the sector in which KRL operates, experiencing a particularly strong recovery.

KRL anticipates that it will record strong sales growth relative to the foodservice industry as a whole in the future, as it has historically. KRL remains committed to growth, both through expansion into new markets and same store sales increases. In addition to building new Kegs in both Canada and the U.S., we continue to refurbish, and in some cases relocate, existing Keg restaurants in order to better serve our guests and to protect and enhance the strong leadership position The Keg brand has enjoyed for over thirty years.

RISKS AND UNCERTAINTIES

Management of KRL continues to anticipate certain risks and uncertainties associated with the ordinary course of business. Such risks and uncertainties include the competitive nature of the restaurant industry, the availability and quality of raw materials, the ability of KRL to maintain and grow Keg restaurants, government regulation and fluctuation in foreign currency, among others.

Management continues to monitor the situation regarding the two cases of BSE found in North America during 2003. The widespread testing of herds confirms these are isolated cases; the risk to human health appears to be negligible. Most importantly to The Keg, there has not been any significant negative consumer reaction to beef in North America and there has not been a material impact on our restaurant traffic. KRL has maintained an uninterrupted supply of quality beef that meets our demanding specifications despite the border closures and the unfortunate impact on cattle producers. We expect the demand for beef to remain strong among consumers and our supply to continue uninterrupted.

FORWARD LOOKING INFORMATION

The information provided in this report includes forward-looking statements with respect to business plans, activities, prospects, opportunities and events anticipated or being pursued by management of KRL and KRL's future results. Although management of KRL believes the assumptions underlying such statements to be reasonable, any of the assumptions may prove to be inaccurate and, as a result, the forward-looking information may prove to be incorrect. The anticipated results or events upon which current expectations are based may differ materially from actual results or events. The forward-looking information contained in this document is current only as of the date of this document. There should not be an expectation that such information will in all circumstances be updated, supplemented or revised whether as a result of new information, changing circumstances, future events or otherwise.

AUDITORS' REPORT TO THE DIRECTORS OF KEG RESTAURANTS LTD.

We have audited the consolidated balance sheets of Keg Restaurants Ltd. as at September 28, 2003 and September 29, 2002 and the consolidated statements of operations and deficit and cash flows for the 52 week periods then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 28, 2003 and September 29, 2002 and the results of its operations and its cash flows for the 52 week periods then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Vancouver, Canada

November 27, 2003

CONSOLIDATED BALANCE SHEETS

(Expressed in thousands of dollars)

	September 28, 2003	September 29, 2002
ASSETS		
Current assets:		
Cash	$ 1,313	$ 10,859
Restricted cash (note 12(b)(ii))	750	2,000
Short-term investment (note 13)	-	18,318
Accounts receivable	2,839	2,952
Inventories	3,848	3,488
Prepaid expenses and deposits	3,183	2,398
Current portion of notes receivable	143	139
Property, plant and equipment held for resale (note 4)	-	2,289
	12,076	42,443
Long-term investments (note 5)	28,829	28,516
Notes receivable (note 6)	68	316
Due from related company (note 13)	219	-
Property, plant and equipment (note 7)	46,013	35,897
Deferred charges	3,177	3,060
Future income taxes (note 8)	6,340	6,238
	$ 96,722	$ 116,470
LIABILITIES AND SHAREHOLDER'S DEFICIENCY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 22,571	$ 19,662
Unearned revenue	5,450	4,657
Current portion of long-term debt	543	581
	28,564	24,900
Note payable to The Keg Royalties Income Fund (note 9)	57,000	57,000
Long-term debt (note 10)	6,158	7,805
Deferred gain on sale of intangible assets (note 3)	37,105	37,484
Shareholder's deficiency:		
Share capital (note 11)	1	1
Cumulative translation adjustment	(2,153)	701
Deficit	(29,953)	(11,421)
	(32,105)	(10,719)
	$ 96,722	$ 116,470

Commitments and contingent liabilities (note 12)

Subsequent events (note 20)

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board

David Aisenstat, Director

Neil Maclean, Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

(Expressed in thousands of dollars)

	52 weeks ended September 28, 2003	52 weeks ended September 29, 2002
System sales (note 16)	$ 291,877	$ 276,994
Revenue:		
Restaurant sales	$ 163,934	$ 162,375
Retail sales	3,579	5,316
	167,513	167,691
Operating costs:		
Restaurant operating costs	145,383	139,986
Retail operations	3,850	5,190
	149,233	145,176
Earnings from operations	18,280	22,515
Equity income (note 5)	5,457	1,767
Franchise fee income	6,037	5,307
Other investment income	-	32
	29,774	29,621
Royalty expense	10,958	3,628
General and administrative expenses (note 13)	12,600	14,099
Executive bonus (note 13)	-	2,410
Earnings before undernoted items	6,216	9,484
Amortization	7,479	7,007
Amortization of deferred gain (note 3)	(379)	(127)
Interest	4,826	5,101
Loss on disposal of property, plant and equipment	148	365
Loss before long-term debt settlement and income taxes	(5,858)	(2,862)
Long-term debt settlement expenses	-	11,206
Loss before income taxes	(5,858)	(14,068)
Income taxes (note 8):		
Current	(2)	60
Future (recovery)	(102)	(3,731)
	(104)	(3,671)
Net loss for the period	(5,754)	(10,397)
Deficit, beginning of period	(11,421)	(1,024)
Dividends (note 13)	(12,778)	-
Deficit, end of period	$ (29,953)	$ (11,421)

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars)

	52 weeks ended September 28, 2003	52 weeks ended September 29, 2002
Cash provided by (used for):		
OPERATIONS:		
Net loss for the period	$ (5,754)	$ (10,397)
Items not involving cash:		
Amortization	7,479	7,007
Amortization of deferred gain	(379)	(127)
Share of equity earnings from investments	(5,457)	(1,799)
Loss on disposition of property, plant and equipment	148	365
Write-off of deferred financing charges	-	1,268
Future income tax recovery	(102)	(3,731)
Change in non-cash operating working capital (note 18(a))	3,024	4,303
	(1,041)	(3,111)
INVESTMENTS:		
Additions to property, plant and equipment and deferred charges	(22,019)	(15,167)
Net proceeds (costs) from disposition of property, plant and equipment	28	(5)
Proceeds from disposition of property, plant and equipment held for resale	2,126	-
Short-term investment (note 13)	5,320	(18,318)
Distributions and advances from investments	5,055	1,346
Proceeds from sale of intangible assets (note 3)	-	30,487
Costs incurred on sale of intangible assets	-	(322)
Notes receivable	244	(253)
Restricted cash	1,250	(2,000)
	(7,996)	(4,232)
FINANCING:		
Loan from The Keg Royalties Income Fund	-	57,000
Shareholder loan	209	(135)
Due from related company	(219)	-
Accrued long-term debt commitment fees	-	(1,812)
Issuance of long-term debt	-	8,629
Repayment of long-term debt	(499)	(47,863)
	(509)	15,819
Increase (decrease) in cash	(9,546)	8,476
Cash, beginning of period	10,859	2,383
Cash, end of period	$ 1,313	$ 10,859

See note 18(b) for supplementary cash flow information.
See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

1. OPERATIONS:

Keg Restaurants Ltd. ("KRL"), was formed by the amalgamation of Resolut Corporation, Raleigh Corporation, Raleigh Investments Ltd., Raleigh Restaurants Inc. and Keg Restaurants Ltd. under the laws of Ontario. Its principal business activity is the operation and franchising of Keg steakhouse restaurants and bars in Canada and the United States.

2. SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of accounting:

These consolidated financial statements include the accounts of KRL and its wholly owned subsidiary, Keg Restaurants U.S., Inc. and have been prepared in accordance with Canadian generally accepted accounting principles. The investment in a joint venture is accounted for using the proportionate consolidation method. Under this method, KRL's proportionate share of joint venture revenues, expenses, assets and liabilities are included in the accounts.

(b) Short-term investment:

The short-term investment consisted of redeemable preferred shares which were stated at the lower of cost or market value. The preferred shares were redeemed prior to the end of fiscal 2003 (note 13).

(c) Inventories:

Inventories, which consist of food, beverages and tableware, are stated at the lower of cost (first-in, first-out) and replacement cost.

(d) Long-term investments:

i. Investment in The Keg Rights Limited Partnership:

The investment in The Keg Rights Limited Partnership (the "Partnership"), a subsidiary of The Keg Royalties Income Fund (the "Fund"), is accounted for using the equity method. Under the equity method, the original cost of the investment is adjusted for KRL's share of post-acquisition earnings or losses and is reduced for distributions or advances received.

ii. Investment in the Keg GP Ltd.:

The investment in the Keg GP Ltd. ("KGP") is stated at cost.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(e) Property, plant and equipment:

Property, plant and equipment are stated at cost less accumulated amortization and write-downs. Amortization is provided on a straight-line basis at the following annual rates:

Description	Rate
Buildings	20 years
Buildings on leased land	Lesser of 20 years and term of the lease plus the first renewal option
Equipment and furnishings	6 years
Leasehold improvements	Lesser of 20 years and term of the lease plus the first renewal option

KRL reviews the carrying value for property, plant and equipment on an ongoing basis, taking into consideration any events or circumstances which might have impaired the carrying value. If a permanent decline in the carrying amount is determined, the asset is written down to its estimated net recoverable amount.

(f) Deferred charges:

Deferred charges consist of direct costs associated with opening a new restaurant, which primarily includes training, operational testing and advertising and are amortized over three years, commencing the month after the restaurant opens. Commitment and financing fees are also included in deferred charges and are amortized over the lesser of 5 years and the term of the loan.

(g) Deferral and amortization of gain on sale of intangible assets:

The gain on the sale of intangible assets is deferred and amortized on a straight-line basis over the 99-year term of the licence (note 3).

(h) Income taxes:

KRL uses the asset and liability method of accounting for future tax assets and liabilities and recognized the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Where it is considered to be more likely than not that the future income tax assets will not be realized, a valuation allowance is provided for the difference.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(i) Revenue recognition:

Revenue from restaurant operations is recognized when services are rendered.

Franchise fees are recorded as they are earned which, in the case of initial franchise fees for the sale of a franchise, is at the time the restaurant is opened.

Unearned revenue consists primarily of the aggregate redemption amounts of gift certificates issued during the last two years which remain unredeemed. The amount of any certificates previously included in income is expensed in the year of redemption.

(j) Vacant leasehold property:

KRL recognizes all future net costs related to vacant leasehold property as a property expense in the period in which it decides to stop using the property. The amount is determined using management's best estimate of net cash flows such as lease payments, operating costs and sub-lease income.

(k) Foreign currency:

KRL's functional currency is the Canadian dollar. KRL uses the current rate method of accounting for the translation of its U.S. operations. Under this method, assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the year-end rate of exchange. Revenue and expenses are translated at the average rates during the period. Exchange gains and losses resulting from the translation are deferred and included as a separate component of shareholder's deficiency.

(l) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination of unearned revenue, impairment in the value of assets, useful lives for depreciation and amortization, income taxes and provisions for contingencies. Actual results could differ from those estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

3. SALE OF INTANGIBLE ASSETS:

On May 31, 2002, KRL sold its trademarks, trade names, operating procedures and systems and other intellectual property used in connection with the operation of the Keg restaurants, and all goodwill associated therewith (collectively the "Keg Rights") to the Partnership for proceeds of $113,546,820. The gain on sale was determined as follows:

Cash	$ 30,487
Partnership Units:	
Class A	9,059
Class B	17,000
Class C	57,000
	113,546
Disposition costs	(322)
Net book value of intangible assets	(20,423)
Gain on sale on intangible assets	92,801
Portion of gain relating to KRL's ownership interest in the Partnership	(55,190)
Deferred gain on sale, May 31, 2002	37,611
Amortization for fiscal 2002	(127)
Deferred gain on sale, September 29, 2002	$ 37,484
Amortization for fiscal 2003	(379)
Deferred gain on sale, September 28, 2003	$ 37,105

Concurrent with the sale of the Keg Rights, the Partnership granted KRL a licence to use the Keg Rights for a period of 99 years. As consideration, KRL will pay the Partnership a royalty of four percent of system sales reported by the Keg restaurants to KRL as defined in the licence and royalty agreement entered into between KRL and the Partnership. Accordingly, the gain on sale has been deferred and will be recognized over the term of the licence. For the 52 weeks ended September 28, 2003, $379,910 (52 weeks ended September 29, 2002 - $126,637) of the deferred gain was amortized.

As a result of the transaction, KRL holds all of the Class A Units, Class B Units and Class C Units issued by the Partnership.

The Class A Partnership Units are entitled to a preferential proportionate distribution equal to the distribution on the Class C Partnership Units, multiplied by the number of Class A Units, divided by the number of Limited Partnership Units issued and outstanding. The Keg Holdings Trust ("KHT"), a wholly-owned subsidiary of The Keg Royalties Income Fund (the "Fund"), holds all of the 8,153,500 Limited Partnership Units issued and outstanding at September 28, 2003.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

3. SALE OF INTANGIBLE ASSETS (CONTINUED):

In addition, the Class A Units receive a residual distribution proportionately with the Class B Units, Limited Partnership Units and General Partnership Units relative to the aggregate number of each class issued and outstanding (or in the case of Class B Units, the number issued and outstanding multiplied by the Class B current distribution entitlement). Class A Units are exchangeable for units of the Fund ("Fund Units") on the basis of one Fund Unit for one Class A Unit.

The Class B Partnership Units are entitled to a preferential proportionate distribution and a residual distribution based on the amount of incremental royalties paid to the Partnership from new Keg restaurants. The distribution entitlements of the Class B Units are adjusted annually on January 1. Class B Units are exchangeable for Fund Units based upon a defined calculation that itself is based on net sales from new restaurants and approximates one Fund Unit for one Class B Unit. As at September 28, 2003, 269,351 Class B Units are entitled to receive distributions and may be exchanged for Fund Units. These 269,351 Class B Units represent 80% of KRL's estimated Class B Unit entitlement calculated on the January 1, 2003 determination date. This entitlement will be adjusted on December 31, 2003 to reflect the actual sales for those restaurants included in the royalty pool on January 1, 2003.

The Class C Partnership Units are entitled to a preferential monthly distribution equal to $0.0625 per Class C Unit issued and outstanding. KRL has the right to transfer Class C Units to KHT, in consideration for the assumption by KHT of an amount of the note payable by KRL to the Fund equal to $10.00 for each Class C Unit transferred.

All Fund Units obtained by KRL in exchange for the above Partnership units are subject to a contractual resale restriction, which expires on May 31, 2005.

4. PROPERTY, PLANT AND EQUIPMENT HELD FOR RESALE:

The property, plant and equipment held for resale consisted of land for a restaurant located in Las Colinas, Texas. During 2003, the land was sold and leased back under an operating lease. The proceeds of the sale were equal to the carrying value of the land.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

5. LONG-TERM INVESTMENTS:

	September 28, 2003	September 29, 2002
The Keg Rights Limited Partnership:		
Balance, beginning of period	$ 28,322	$ -
905,944 Class A Units of the Partnership	-	9,059
3,376,700 Class B Units of the Partnership	-	17,000
5,700,000 Class C Units of the Partnership	-	57,000
	-	83,059
Portion of gain on sale of Keg Rights relating to KRL's ownership interest in the Partnership (note 3)	-	(55,190)
	-	27,869
Equity income	5,457	1,767
Distributions advanced from the Partnership	(4,984)	(1,314)
Balance, end of period	28,794	28,322
Saskatoon Property Partnership	34	193
The Keg GP Ltd.	1	1
	$ 28,829	$ 28,516

During 2003, the Saskatoon Property Partnership sold the land and building it was leasing to a Keg franchised restaurant in Saskatoon to a third party. KRL's share of the loss on the sale of the land and building was $86,882 and has been recorded as a reduction in the value of the investment. As the lease of the land was the principal purpose of the partnership, it will be dissolved and the remaining assets distributed to the partners on December 31, 2003.

The investment in KGP consists of 10 common shares, which represents 10% of the issued and outstanding common shares as at September 28, 2003 (September 29, 2002 - 10%). KGP is the managing general partner of the Partnership. The remaining common shares of KGP are owned by the Fund, an unincorporated open-ended limited purpose trust. Fund Units are traded on the Toronto Stock Exchange.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

6. NOTES RECEIVABLE:

	September 28, 2003	September 29, 2002
Note receivable without interest, due June 26, 2005	$ 75	$ 75
Employee relocation loan without interest, no fixed terms of repayment	68	79
Demand note receivable with interest at 12% per annum, no fixed terms of repayment	68	-
Note receivable without interest, due on demand	-	10
Note receivable with fixed weekly payment of US$968, including interest at 10% per annum, until maturity on March 26, 2007 (a)	-	291
	211	455
Current portion	143	139
	$ 68	$ 316

(a) The note receivable was obtained as consideration for the sale of an existing restaurant to a franchisee. The note was repaid during fiscal 2003.

7. PROPERTY, PLANT AND EQUIPMENT:

	Cost	Accumulated amortization	September 28, 2003 Net book value
Buildings	$ 17,126	$ 4,268	$ 12,858
Equipment and furnishings	38,807	29,670	9,137
Leasehold improvements	39,074	27,342	11,732
Construction in progress	12,286	-	12,286
	$ 107,293	$ 61,280	$ 46,013

	Cost	Accumulated amortization	September 29, 2002 Net book value
Buildings	$ 12,322	$ 3,801	$ 8,521
Equipment and furnishings	38,338	29,866	8,472
Leasehold improvements	39,631	25,609	14,022
Construction in progress	4,882	-	4,882
	$ 95,173	$ 59,276	$ 35,897

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

8. INCOME TAXES:

Income tax recovery as reported differs from the amount that would be computed by applying the combined Federal and Provincial statutory income tax rates to the loss before income taxes. The reason for the differences is as follows:

	52 weeks ended September 28, 2003	52 weeks ended September 29, 2002
Loss before income taxes	$ (5,858)	$ (14,086)
Combined Canadian federal and provincial rates	36.96%	39.1%
Computed "expected" tax recovery	(2,163)	(5,501)
Increased (reduced) by:		
Amounts not deductible for tax	136	814
Change in valuation allowance	(687)	611
Foreign exchange translation	1,815	28
Foreign tax rate differences	139	93
Adjustment to future tax assets and liabilities for enacted changes in tax laws and rates	394	-
Other items	262	284
Total income tax recovery per the statement of operations	$ (104)	$ (3,671)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

8. INCOME TAXES (CONTINUED):

The tax effects of temporary differences that give rise to the future tax assets and liabilities are:

	September 28, 2003	September 29, 2002
Future tax assets:		
Property, plant and equipment	$ 1,288	$ 974
Non-capital losses	10,440	9,320
Deferred gain	6,560	7,613
Long-term debt settlement expenses	2,358	3,094
Unearned revenue and other accruals deductible in future periods for income tax purposes	3,947	3,529
Total gross future tax assets	24,143	24,530
Valuation allowance	(11,293)	(11,979)
Total future tax assets	12,850	12,551
Future tax liabilities:		
Total gross future tax liabilities	(6,510)	(6,313)
Net future tax assets	$ 6,340	$ 6,238

KRL has loss carryforwards remaining of approximately $30.5 million ($24.4 million from its U.S. operations) which may be applied against future operating income. The amount of these loss carryforwards is subject to reassessment by Canada Customs and Revenue Agency and the Internal Revenue Service and is subject to certain restrictions with respect to their use. These losses begin to expire in 2006.

9. NOTE PAYABLE TO THE KEG ROYALTIES INCOME FUND:

On May 31, 2002, KRL issued a note payable to the Fund in exchange for cash of $57,000,000. KRL has the option at any time to retire the note by transferring its 5,700,000 Class C Partnership Units to KHT (note 3).

Interest accrues at 7.5% per annum and is payable monthly, on the third business day immediately prior to the end of the month following the month for which such interest has accrued. Included in interest expense is $4,263,288 (52 weeks ended September 29, 2002 - $1,428,904) relating to this note of which $3,572,261 (52 weeks ended September 29, 2002 - $1,089,247) had been paid as at September 28, 2003 and $691,027 (September 29, 2002 - $339,657) is included in accounts payable and accrued liabilities.

The principal amount matures on May 31, 2042 and is subject to extension by the mutual agreement of KRL and the Fund.

The note is secured by a general security agreement, including accounts receivable and inventories, that is subordinated to primary bank debt obligations and may not be assigned without the prior consent of KRL.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

10. LONG-TERM DEBT:

	September 28, 2003	September 29, 2002
GE Capital (U.S. $4.947 million)	$ 6,701	$ 8,386
Current portion	(543)	(581)
	$ 6,158	$ 7,805

The debt is repayable in fixed monthly instalments, including interest rates varying from 8.24% to 8.87%, is secured by certain property, plant and equipment in the states of Washington, Texas and Colorado and continues to be used for the expansion of restaurant operations in the United States.

Future minimum principal payments as at September 28, 2003, under the long-term debt agreements, are as follows:

2004	$ 543
2005	592
2006	644
2007	702
2008	764
Thereafter	3,456
	$ 6,701

11. SHARE CAPITAL:

Authorized:
1,000 common shares with a par value of $1 per share.

	September 28, 2003	September 29, 2002
Issued:		
100 common shares	$ 1	$ 1

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

12. COMMITMENTS AND CONTINGENT LIABILITIES:

(a) Operating leases:

Minimum rentals under head leases extending to the year 2023 (excluding CPI adjustment factors and rentals based on sales) are approximately as follows:

	Total	Sub-lease reimbursement	Net
2004	$ 11,929	$ (2,366)	$ 9,563
2005	10,908	(1,938)	8,970
2006	9,970	(1,744)	8,226
2007	9,197	(1,514)	7,683
2008	8,896	(1,504)	7,392
Thereafter	42,752	(3,202)	42,550

Under the terms of certain lease agreements, KRL is contingently liable to the landlord for any default in payment by sub-lessees. At September 28, 2003, substantially all sub-lease accounts were current.

(b) Contingent liabilities:

i. KRL has been named as a defendant in various lawsuits that are currently pending. In those cases where an unfavourable outcome is likely, a provision for anticipated costs has been accrued. In determining the estimated exposure for pending lawsuits, KRL relies upon their understanding of the claim, including activities undertaken by the other party, as well as discussions with legal counsel. In the opinion of management, the remaining lawsuits are without substantial merit and no provision has been made for them.

ii. KRL has issued letters of credit, in the normal course of business, totalling Cdn$429,000 and US$7,500. These amounts are covered by a $750,000 cash deposit which is restricted for use as collateral for the various credit facilities.

13. RELATED PARTY TRANSACTIONS:

KRL provided services to Hy's of Canada Ltd., a company partially owned by the sole shareholder of KRL, under the terms of a management agreement. KRL's revenue for these services for the 52 weeks ended September 28, 2003, which amounted to $200,000 (52 weeks ended September 29, 2002 - $20,000), has been recorded as a reduction in general and administrative expenses. Also, during fiscal 2003, Hy's of Canada Ltd. agreed to reimburse KRL $500,000 as settlement for a guarantee obligation initially entered into in 1981 related to an ongoing property lease. This amount is included in accounts receivable at September 28, 2003. During the 52 weeks ended September 28, 2003, $410,000 has been recorded as a reduction in general and administrative expenses and the remaining $90,000 has been accrued for costs expected to be incurred in future years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

13. RELATED PARTY TRANSACTIONS (CONTINUED):

During fiscal 2003, no executive bonus was earned (52 weeks ended September 29, 2002 - $2,410,000).

At September 28, 2003, $224,000 (September 29, 2002 - $15,000) due to the shareholder of KRL is included in accounts payable and accrued liabilities.

The short-term investment of $18,317,600 consisted of redeemable preferred shares in a company controlled by the shareholder of KRL. During fiscal 2003, KRL redeemed $5,320,166 of the shares for cash and $12,778,000 as settlement of a dividend payable to its shareholder. At September 28, 2003, the remaining $219,434 amount of the preferred share redemption is recorded as due from the related party.

14. JOINT VENTURE:

KRL has a 50% investment in an incorporated joint venture, Sedan (Coquitlam) Enterprises Ltd.. Earnings and distributions to the participants are based on their proportionate interest in the joint venture. KRL's share of income from the joint venture for the 52 weeks ended September 28, 2003 was $2,000 (52 weeks ended September 29, 2002 - loss of $5,000); KRL's share of sales was $1,373,000 (52 weeks ended September 29, 2002 - $1,317,000).

15. FINANCIAL INSTRUMENTS:

(a) Fair value:

KRL's financial instruments include cash, accounts receivable, notes receivable, accounts payable and accrued liabilities and long-term debt. The carrying values of these instruments approximate their fair values. Due to the interrelationship between the note payable to the Fund, described in note 9, and the Class C Partnership Units, described in note 3, it is not practical to estimate the fair value of the note payable with sufficient reliability.

(b) Interest rate risk:

Interest on KRL's long-term debt is based on a fixed rate and exposes KRL to interest rate risk. KRL has not entered into any derivative agreements to mitigate this risk.

(c) Concentration of credit risk:

KRL's revenues are generated from restaurant sales which are not significantly exposed to credit risk due to their immediate or short-term nature of collection. In addition, as these sales are from restaurants that are geographically dispersed and to a large number of individual customers, concentration of credit risk is considered to be limited.

(d) Exchange risk:

KRL is exposed to currency exchange risk as a result of its operations in the United States. To manage its exchange risk, KRL's subsidiary in the United States, Keg Restaurants U.S., Inc., entered into financing arrangements in United States dollars. KRL has not entered into any derivative agreements to further mitigate this risk.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

16. SYSTEM SALES:

System sales for any period and for any Keg restaurants located in Canada and the United States means the Gross Sales by such Keg restaurants for such period.

Gross Sales are the sales reported to KRL by owners of Keg restaurants in Canada and the United States under franchise agreements, without audit or other form of independent assurance, and the sales of Keg restaurants in Canada and the United States owned by KRL and its subsidiaries. In each case, these sales are reported net of discounts for coupons and other promotional items and applicable sales taxes.

17. SEGMENT DISCLOSURES:

KRL's principal business activity is the operation and franchising of Keg Steakhouse and Bar restaurants in Canada and the United States; as a result, KRL is considered to operate in only one reportable segment.

GEOGRAPHIC INFORMATION:

	52 weeks ended September 28, 2003	52 weeks ended September 29, 2002
Restaurant sales:		
Canada	$ 100,492	$ 100,941
United States	63,442	61,434
	$ 163,934	$ 162,375
Franchise fee revenue:		
Canada	$ 5,939	$ 5,255
United States	98	52
	$ 6,037	$ 5,307

	September 28, 2003	September 29, 2002
Property, plant and equipment:		
Canada	$ 19,601	$ 11,996
United States	26,412	23,901
	$ 46,013	$ 35,897

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

18. SUPPLEMENTARY CASH FLOW INFORMATION:

	52 weeks ended September 28, 2003	52 weeks ended September 29, 2002
(a) Change in non-cash operating working capital:		
Accounts receivable	$ 113	$ (1,454)
Inventories	(360)	(824)
Prepaid expense and deposits	(785)	(81)
Accounts payable and accrued liabilities	2,700	6,209
Unearned revenue	793	439
Cumulative translation adjustment	563	14
	$ 3,024	$ 4,303
(b) Supplementary information:		
Interest received	$ 177	$ 140
Interest paid	4,976	4,132
Income taxes paid	16	4
Non-cash transactions:		
Proceeds received from the redemption of preferred shares recorded as a short-term investment in exchange for settlement of the following:		
Dividends payable to shareholder	12,778	-
Investment in the Keg Rights Limited Partnership in exchange for partial payment on sale of intangible assets	-	27,869

19. COMPARATIVE FIGURES:

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted in the current period.

20. SUBSEQUENT EVENTS:

(a) On September 30, 2003, KRL entered into a $5,250,000 credit facility agreement with a major Canadian chartered bank. The facility includes a demand loan in the amount of $4,000,000, the proceeds of which have been used solely for the expansion of restaurant operations in Canada and a facility available for outstanding letters of credit to a maximum amount of $1,250,000. The debt is secured by a general security agreement over assets owned by KRL in Canada and a demand promissory note in the principal amount of $4,000,000.

The $4,000,000 demand loan requires monthly interest payments at prime plus 0.375% until March 4, 2004, then monthly principal payments of $66,666 plus interest until June 30, 2005 when full repayment of the outstanding principal is due.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

52 weeks ended September 28, 2003
52 weeks ended September 29, 2002

20. SUBSEQUENT EVENTS (CONTINUED):

(b) Subsequent to September 28, 2003, KRL's wholly owned subsidiary, Keg Restaurants U.S., Inc., obtained debt financing in the amount of US$3,500,000 for expansion of restaurant operations in the United States. The debt is secured by certain property, plant and equipment held in Washington, Texas and Arizona.

Fixed monthly payments, including interest at rates varying from 7.43% to 8.46% are required according to the following repayment schedule:

December 2003 - November 2010	US$37,097
December 2010 - November 2018	US$29,446

UNITHOLDER INFORMATION

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BOARD OF TRUSTEES

BOARD OF DIRECTORS AND OFFICERS OF THE KEG GP LTD., THE GENERAL PARTNER OF THE KEG RIGHTS LIMITED PARTNERSHIP

REGISTRAR AND TRANSFER AGENT

Computershare Trust Company of Canada

STOCK EXCHANGE LISTING

Toronto Stock Exchange: KEG.UN

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